

SAIS Accreditation

General Guide to Understanding Audited Financial Statements

The following is a general guide to assist third-party compliance reviewers in understanding an independent school's audited financial statements and footnotes.

Preface

The independent audit gives the general public assurance that the school's financial statements are fairly stated and can be relied on. It is important to understand that it is management's responsibility for capturing the accounting data throughout the fiscal year that eventually generate the account balances reported on the financial statement and footnotes. It is the auditor's responsibility to express an opinion based on their audit work.

A school's financial statements should be prepared on the accrual basis of accounting which is in accordance with Generally Accepted Accounting Principles (GAAP). Financial statements prepared under the cash or modified cash basis is an Other Comprehensive Basis of Accounting method and does not present accurately the financial picture of the school.

Auditor's Report

1. The word "Independent" must be included in the auditor's report title.
2. The report is required to cover the school's fiscal year end.
3. The report must opine on the basic financial statements of the school which consist of the **statement of financial position** (balance sheet) and the related **statements of activities and cash flows**.
4. To determine whether the school received an "unqualified opinion" (clean opinion), read the paragraph that begins with "In our opinion...." and determine whether the auditors are stating that without any exceptions, do not present fairly, or do not express an opinion.
5. Consider the reasons if the auditor's report date is over six months after the school's year end. This could indicate there were problems during the audit.

Financial Statements

6. The **statement of financial position** measures the school's financial health at a point of time and provides information about the liquidity of their financial position. In other words, are they likely to have enough cash in the near future to pay their bills as these come due? There are three classes of net assets (unrestricted, temporarily restricted, and permanently restricted). A school with a negative (deficit) in unrestricted net assets may require consideration of nonfinancial factors in order to gauge its financial health.

7. The **statement of activities** shows all the school's financial activity from the beginning to the end of the fiscal year. The increases or decreases in the school's net assets (net income or loss) is one indicator of whether its financial health is improving or deteriorating.

8. The **statement of cash flows** reports cash receipts, cash payments and net changes in cash resulting from operating, investing, and financing activities. It provides answers to such questions as "Where did cash come from?" "What was cash used for?" and "What was the change in cash balance during the fiscal year?" **Cash flows from operating activities** is the area you should focus your attention on because it paints the best picture of how well a school's business (education) operations are producing cash that will ultimately benefit the future, as opposed to peripheral activities such as investing and borrowing.

9. The **notes to the financial statements** are considered the "fine print" of the school's financial information and we should always "read the fine print". The notes help explain specific items in the financial statements as well as provide a more comprehensive assessment of the school's financial condition. The notes should be read in order to identify important matters such as accounting methods, impairment of assets, maturity dates of long-term debt, going concern issues, contingent liabilities such as lawsuits, and important subsequent events, if any.

Other

10. A list of adjusting journal entries provided by the school's audit firm should be obtained and consideration should be given to the type and number of adjustments made to the school's books. Several journal entries may be an indication that a weakness in the school's internal controls over financial reporting exists. In other words, monthly financial statements that were provided to the board during the year which were used in making business decisions could be considered unreliable.

11. A copy of the **management letter** and the **SAS 114 Letter** (the auditor's communication with those charged with governance) issued by the school's audit firm should be obtained and read. These letters require the audit firm to communicate audit matters that are significant

and relevant to the audit committee or board of directors on a timely basis so appropriate action can be taken, if necessary. Examples of such matters may include difficulties the audit firm encountered in performing the audit, corrected and uncorrected misstatements, disagreements with management, management consultations with other accountants about auditing and accounting matters, audit findings or issues, and weaknesses in internal controls along with opportunities for strengthening internal controls over financial reporting.

NOTE: This document was created by Paul Chancey (pchancey@cbh.com), CPA, of [Cherry Bekaert and Holland](#) as a general guide for the non-CPA reviewer to use in an SAIS Accreditation visit.